

Minnesota

Department of Finance

July 2006

FY 2006 Receipts Up Revenue Outlook Unchanged

Minnesota's net general fund receipts for FY 2006 are now estimated to total \$15.481 billion, \$447 million (3.0 percent) more than forecast in February. The individual income tax and the corporate income tax had the largest positive variances. "Other" revenues were \$82 million above forecast.

Summary of Tax Receipts: Fiscal Year 2006

	<u>Estimate</u>	<u>Actual</u>	<u>Variance</u>	<u>%</u>
	----- (\$ in millions) -----			
Individual	\$6,614	\$6,875	\$261	3.9
Sales	4,468	4,467	(1)	0.0
Corporate	956	1,062	106	11.1
Motor Vehicle	250	249	(1)	(0.3)
Other	2,746	2,828	82	3.0
Total	\$15,034	\$15,481	\$447	3.0

Nearly one-half the forecast variance came from settlement of tax year 2005 individual income tax liabilities. Final payments for tax year 2005, including those accompanying extensions, were \$128 million more than forecast. Individual income tax refunds for tax year 2005 were \$75 million less than projected (see page 4.) FY 2006 withholding receipts exceeded the forecast by \$63 million. The corporate income tax variance also was primarily due to lower than projected refunds and higher than anticipated final payments. Corporate estimated payments for the current tax year were \$23 million above forecast, but \$12 million below forecast in the last quarter. To this point refund payments associated with the Hutchinson decision have been less than Department of Revenue projections. That may, however, only reflect the timing of payments and not the amounts to be ultimately paid out in refunds.

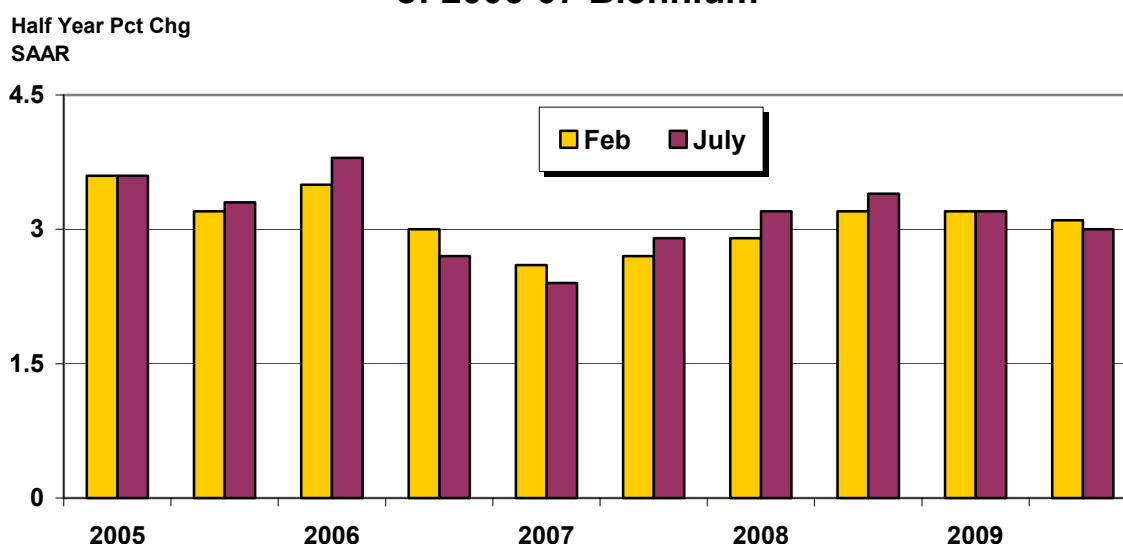
All FY 2006 results are preliminary and subject to change. As in past years, in this first report of receipts for the entire fiscal year, forecasts for some revenue sources were adjusted to reflect anticipated accruals. A complete accounting of FY 2006 revenues, reflecting final closing, will be part of October's *Economic Update*.

National Economy Expected to Slow in Second Half of 2006

It takes time for the economy to respond to changes in monetary policy. That means the Fed needs to begin tightening before inflationary pressures have become well established. It also means that the Fed should conclude its tightening before the economic data shows conclusively that inflation is under control. Many economists now believe that it is time for a pause in Fed rate hikes. They believe the Fed's actions over the past two years are sufficient to tap off any further inflationary excesses that might emerge over the next few months. Holding the line on interest rates, they argue, will keep the economy on track for an extended period of sustained real growth with modest inflation. The weakening housing market and less than robust employment growth in April, May, and June lend support to that position.

Most of those same economists, however, expect a further interest rate increase in August. The Fed often tightens a little more than is necessary, and this could well be one of those times. Certainly recent wage growth and the continuing uncertainty about energy prices and their impact on consumer spending and inflation leave room for concern. Minnesota's national economic consultant, Global Insight Inc., (GII) is among those who expect one more hike. Their July baseline forecast also calls for further weakening in the economy in the last half of 2006, with real GDP growing at a 2.7 percent annual rate. GII now projects that real GDP will grow at a 2.9 percent annual rate in fiscal year 2007. February's forecast called for growth of 3.0 percent.

Slower Real GDP Growth Projected for Remainder of 2006-07 Biennium



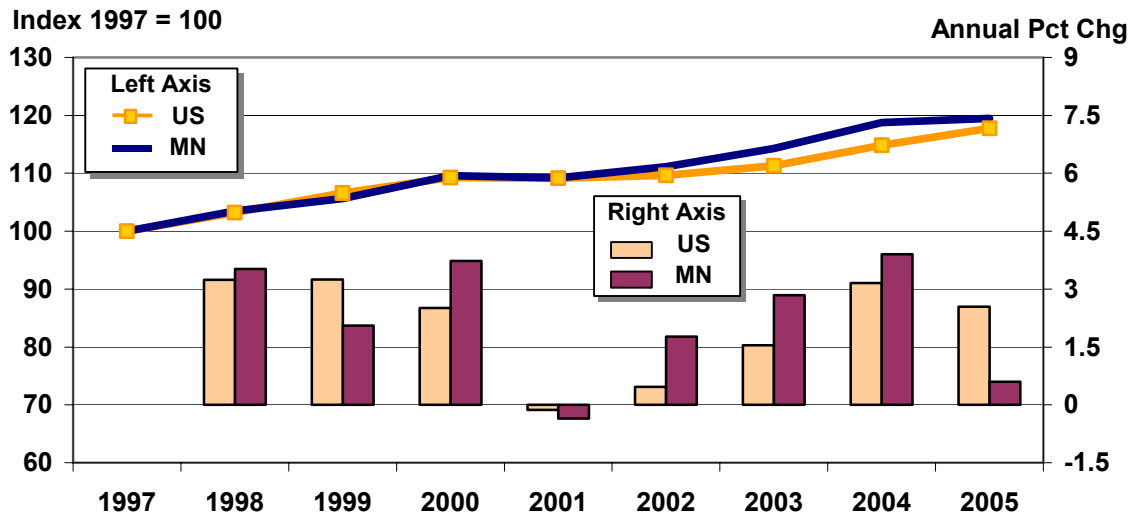
GII also expects slightly higher inflation during fiscal year 2007, with the CPI growing by 2.9 percent over the next 12 months. Oil prices are expected to

remain above \$60 per barrel through the end of the biennium. Global Insight assigns a probability of 55 percent to their baseline forecast, the same as in February. A more pessimistic scenario, which does not include a recession, is assigned a probability of 25 percent, and a more optimistic scenario, a probability of 20 percent.

Real Per Capita GSP in Minnesota Was 110 Percent of the US Average in 2005

Advance estimates from the U.S. Department of Commerce show Minnesota ranking 9th on per capita Gross State Product (GSP) in 2005. GSP is the most comprehensive measure of state economic output. In 2004 the state ranked 7th, at 112 percent of the U.S. average. Since 1997 per capita output in Minnesota has grown by nearly 20 percent after adjusting for inflation. Minnesota's annual growth rate of 2.2 percent during that period also exceeds the national rate of 2.06 percent. That strong performance came even though per capita output fell more in the recession year of 2001 than it did on average over the rest of the nation. In 2001 real GSP per capita in Minnesota fell by 0.36 percent, for the entire U.S. output per capita fell by only 0.13 percent.

Real GSP Per Capita In Minnesota Has Grown Faster Than The U.S. Average Since 1997



Current Department of Commerce estimates show Minnesota's economy grew considerably slower than the U.S. economy during 2005. The advance 2005 estimate has real GSP per capita in the state increasing by just 0.6 percent, well below the 2.5 percent growth rate reported for the nation as a whole. Minnesota's poor performance in 2005 appears to be due to preliminary estimates of the state's agricultural production. The estimates of agricultural production and GSP are likely to be raised when revised data is released in October.

COMPARISON OF ACTUAL AND ESTIMATED NON-RESTRICTED REVENUES

(\$ in thousands)

	2006 Fiscal Year-to-Date			April - June 2006		
	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
<u>Individual Income Tax</u>						
Withholding	5,482,800	5,545,705	62,905	1,344,781	1,379,310	34,529
Declarations	1,357,400	1,409,769	52,369	567,000	618,282	51,282
Miscellaneous	848,200	919,470	71,270	696,481	767,751	71,270
Gross	7,688,400	7,874,945	186,545	2,608,262	2,765,343	157,081
Refund	1,074,230	999,618	(74,612)	939,452	864,840	(74,612)
Net	6,614,170	6,875,327	261,157	1,668,809	1,900,502	231,693
<u>Corporate & Bank Excise</u>						
Declarations	970,699	994,063	23,364	236,149	224,518	(11,631)
Miscellaneous	125,940	167,148	41,208	(14,762)	11,552	26,314
Gross	1,096,640	1,161,211	64,572	221,387	236,070	14,683
Refund	140,700	99,440	(41,259)	49,608	18,225	(31,383)
Net	955,940	1,061,771	105,831	171,779	217,845	46,066
<u>Sales Tax</u>						
Gross	4,682,900	4,682,865	(35)	1,383,921	1,380,440	(3,481)
Refunds	214,538	215,680	1,142	54,398	68,843	14,445
Net	4,468,362	4,467,184	(1,177)	1,329,523	1,311,597	(17,926)
<u>Motor Vehicle Sales Tax</u>	249,750	248,892	(859)	68,485	70,059	1,574
<u>Other Revenues:</u>						
Estate	203,053	215,936	12,883	12,884	28,136	15,252
Liquor/Wine/Beer	69,360	72,021	2,661	21,453	23,813	2,360
Cigarette/Tobacco/Cont Sub	191,018	197,120	6,102	67,108	71,321	4,213
Deed and Mortgage	294,700	310,587	15,887	74,198	86,693	12,495
Insurance Gross Earnings	287,700	274,210	(13,490)	66,825	55,094	(11,731)
Lawful Gambling	52,446	55,904	3,458	18,481	20,900	2,419
Health Care Surcharge	205,204	205,261	57	52,953	52,013	(940)
Other Taxes	2,889	7,732	4,843	2,136	6,797	4,661
Statewide Property Tax	629,977	630,204	228	346,537	346,602	65
DHS RTC Collections	47,134	54,305	7,171	11,293	14,036	2,742
Income Tax Reciprocity	56,802	56,802	0	0	0	0
Investment Income	33,387	48,563	15,176	3,502	13,945	10,443
Tobacco Settlement	179,060	180,790	1,730	0	1,730	1,730
Departmental Earnings	290,704	301,228	10,524	41,432	50,471	9,039
Fines and Surcharges	94,029	123,132	29,103	25,156	53,923	28,768
Lottery Revenues	40,002	46,608	6,606	9,406	12,395	2,989
Revenues yet to be allocated	0	(7)	(7)	(923)	(1,955)	(1,032)
Residual Revenues	89,858	68,042	(21,816)	37,432	21,094	(16,339)
Sales Tax Rebates (all years)	0	(2)	(2)	2	0	(2)
County Nursing Home Pub Hosp	27,792	30,227	2,435	20,698	23,133	2,435
Other Subtotal	2,795,114	2,878,663	83,549	810,573	880,142	69,569
Other Refunds	48,813	50,530	1,717	22,594	20,603	(1,991)
Other Net	2,746,301	2,828,133	81,831	787,979	859,540	71,560
Total Gross	16,512,804	16,846,575	333,771	5,092,628	5,332,055	239,427
Total Refunds	1,478,281	1,365,269	(113,012)	1,066,052	972,511	(93,541)
Total Net	15,034,523	15,481,306	446,783	4,026,576	4,359,544	332,968